

## PERSONAL AND CORPORATE INCOME TAXES

### **Personal Income Tax**

Forty-three states currently have a personal income tax. New Hampshire and Tennessee tax only "intangible" income (interest and dividends). The remaining 41 states have "broad-based" income taxes, with most sources of income subject to tax. (See Table 1.)

In 1932, Washington voters approved an initiative establishing a personal income tax. However, the State Supreme Court ruled this initiative unconstitutional. Since then, the voters have defeated six constitutional amendments enacting a personal income tax. The last proposal in 1973 was defeated 77 percent to 23 percent. Subsequent efforts at enacting a personal income tax have died in the Legislature.

State income taxes are generally tied in varying degrees to the federal IRS personal income tax statutes. This creates a number of administrative efficiencies for the states. It also makes it simpler for the taxpayer to comply. While most income is subject to tax under a broad-based structure, some sources of income may be considered nontaxable (e.g. certain types of pension income, interest from bonds issued by other government entities). Allowable deductions and personal exemptions may also reduce taxable income for filers and their dependents. Exemptions subtract a fixed amount per household member. Deductions may also subtract a fixed ("standard") amount per return or per return by filing status (single, joint, etc.). States may also allow itemized deductions similar to those allowed under the IRS personal income tax code.

Once taxable income is determined, the entire amount may be subject to tax at a single "flat" rate. Or it may be subject to tax through a "graduated rate" structure, with the marginal tax rate(s) increasing as taxable income increases. (For information on high and low rates by state, see Table 2.)

#### Advantages of Personal Income Tax

- Graduated rates create a "progressive" tax structure, with higher income returns paying a proportionately higher percentage of their income than lower income filers.
- Personal income tax may be partially "exported" to the federal government as state income tax paid is allowed as an itemized deduction. This lowers the amount of federal tax paid by state taxpayers.
- Having a tax tied to the IRS code can create administrative efficiencies and enhance enforcement efforts.

Disadvantages of Personal Income Tax

- Adoption of a personal income tax would require the establishment of a large administrative operation in a relatively short period of time.
- Under the 1932 Supreme Court ruling, the enactment of anything other than a flat rate tax of one percent or less may require a constitutional amendment.
- The prospects for voter approval of a state income tax are not promising in light of the history of prior attempts.

**Corporate Net Income Tax**

Corporate net income tax is currently levied in 46 states. All these states either adopt or heavily refer to the federal IRS corporate income tax code. The application of corporate income tax by states is greatly complicated by multi-state firms and by the complexities of corporate organization. (For information on rates by state, see Table 2.)

By federal law, an out-of-state firm generally must have both a permanent physical presence and employees within a state to be subject to tax. Attribution of profits may be done through "separate accounting" at the establishment level within a state. It may also be done through "apportionment" based on payroll, property and sales. Apportionment methods are not uniform--some states double-weight sales or use sales as the single factor (see Table 3). Further complications are caused by the complexities of corporate organizations, with holding companies and parent-subsidiary relationships. Some states tend to treat corporations within a holding company as separate entities. Others have pursued a "unitary" approach, viewing the overall corporation as the taxable entity.

Advantages of Corporate Income Tax

- Perception of fairness in taxing profits rather than total sales or activity.
- Possibility of interstate cooperation on issues affecting the great majority of states.

Disadvantages of Corporate Income Tax

- Corporate income tax is an extremely volatile tax, with revenue levels subject to great fluctuations and generally much lower during economic downturns.
- Generally, state corporate income taxes are declining as a long-term source of revenue.
- The tax is subject to great accounting complexity and potential manipulation with respect to taxable net income.
- There is no direct relation between profitability and dependence on government services.

**Table 1**  
**Utilization of Retail Sales and Income Taxes**  
**In All States, 2001**

	Retail Sales Tax		Corporate Net Income Tax	Personal Income Tax	
	State	Local		Broad-based	Interest/Dividends Only
Alabama	X	X	X	X	
Alaska		X	X		
Arizona	X	X	X	X	
Arkansas	X	X	X	X	
California	X	X	X	X	
Colorado	X	X	X	X	
Connecticut	X		X	X	
Delaware			X	X	
Florida	X	X	X		
Georgia	X	X	X	X	
Hawaii	X		X	X	
Idaho	X	X	X	X	
Illinois	X	X	X	X	
Indiana	X		X	X	
Iowa	X	X	X	X	
Kansas	X	X	X	X	
Kentucky	X		X	X	
Louisiana	X	X	X	X	
Maine	X		X	X	
Maryland	X		X	X	
Massachusetts	X		X	X	
Michigan	X		X	X	
Minnesota	X	X	X	X	
Mississippi	X		X	X	
Missouri	X	X	X	X	
Montana			X	X	
Nebraska	X	X	X	X	
Nevada	X	X			
New Hampshire			X		X
New Jersey	X		X	X	
New Mexico	X	X	X	X	
New York	X	X	X	X	
North Carolina	X	X	X	X	
North Dakota	X	X	X	X	
Ohio	X	X	X	X	
Oklahoma	X	X	X	X	
Oregon			X	X	
Pennsylvania	X	X	X	X	
Rhode Island	X		X	X	
South Carolina	X	X	X	X	
South Dakota	X	X			
Tennessee	X	X	X		X
Texas	X	X	X		
Utah	X	X	X	X	
Vermont	X	X	X	X	
Virginia	X	X	X	X	
WASHINGTON	X	X			
West Virginia	X		X	X	
Wisconsin	X	X	X	X	
Wyoming	X	X			
Number of States Imposing This Tax	45	34	46	41	2

**Table 2**  
**Personal and Corporate Income Tax Rates, January 1, 2002**

State	Personal Income [1]		Highest Bracket	Rate %	Corporation Income %
	Lowest Bracket	Rate %			
Alabama.....	1st \$500	2	Over \$3,000	5 [2]	6.5
Alaska.....	--	--	--	--	1 to 9.4
Arizona.....	1st \$10,000	2.87	Over \$150,000	5.04	6.968
Arkansas.....	1st \$2,999	1	Over \$25,000	7	1 to 6.5 [2]
California.....	1st \$5,454	1	Over \$35,792	9.3 [2]	8.84
Colorado.....	4.63% of federal taxable income				4.63
Connecticut....	1st \$10,000	3	Over \$10,000	4.5	7.5
Delaware.....	\$2,000-	2.2	Over \$60,000	5.95 [2]	8.7
Florida.....	--	--	--	--	5.5
Georgia.....	1st \$750	1	Over \$7,000	6	6
Hawaii.....	1st \$2,000	1.4	Over \$40,000	8.3	4.4 to 6.4
Idaho.....	1st \$1,000	0.6	Over \$20,000	7.8	7.6
Illinois.....	3% of taxable income				7.3
Indiana.....	3.4% of adjusted gross income [2]				7.9
Iowa.....	1st \$1,162	0.36	Over \$52,290	8.98	6 to 12
Kansas.....	1st \$15,000	3.5	Over \$30,000	6.45	4 [2]
Kentucky.....	1st \$3,000	2	Over \$8,000	6 [2]	4 to 8.25 [2]
Louisiana.....	1st \$10,000	2	Over \$50,000	6	4 to 8
Maine.....	1st \$4,150	2	Over \$16,500	8.5	3.5 to 8.93
Maryland.....	1st \$1,000	2	Over \$3,000	4.75 [2]	7
Massachusetts.	5.3% of taxable income				9.5
Michigan.....	4.1% of adjusted gross income [2]				2.1 [2]
Minnesota.....	1st \$17,570	5.35	Over \$57,710	7.85	9.8
Mississippi.....	1st \$5,000	3	Over \$10,000	5	3 to 5
Missouri.....	1st \$1,000	1.5	Over \$9,000	6 [2]	6.25
Montana.....	1st \$2,100	2	Over \$73,000	11	6.75
Nebraska.....	1st \$2,400	2.51	Over \$26,500	6.68	5.58 to 7.81
Nevada.....	--	--	--	--	--
New Hampshire.	Interest and dividends - 5%				8
New Jersey.....	1st \$20,000	1.4	Over \$75,000	6.37 [2]	9.0
New Mexico.....	1st \$5,500	1.7	Over \$65,000	8.2	4.8 to 7.6
New York.....	1st \$8,000	4	Over \$20,000	6.85 [2]	7.5 [2]
North Carolina...	1st \$12,750	6	Over \$60,000	8.25	6.9
North Dakota....	1st \$3,000	2.1	Over \$50,000	5.54	3 to 10.5
Ohio.....	1st \$5,000	0.743	Over \$200,000	7.5 [2]	5.1 to 8.5 [2]
Oklahoma.....	1st \$1,000	0.5	Over \$10,000	6.65	6
Oregon.....	1st \$2,350	5	Over \$5,850	9 [2]	6.6 [2]
Pennsylvania....	2.8% of taxable income [2]				9.99 [2]
Rhode Island....	25.5% of federal tax				9
South Carolina...	1st \$2,310	2.5	Over \$11,550	7	5
South Dakota....	--	--	--	--	--
Tennessee.....	Interest and dividends - 6%				6
Texas.....	--	--	--	--	4.5 [3]
Utah.....	1st \$750	2.3	Over \$3,750	7	5
Vermont.....	24% of federal tax				7.0 to 9.75
Virginia.....	1st \$3,000	2	Over \$17,000	5.75	6
Washington.....	--	--	--	--	--
West Virginia....	1st \$10,000	3	Over \$60,000	6.5	9
Wisconsin.....	1st \$10,000	4.6	Over \$150,000	6.75	7.9
Wyoming.....	--	--	--	--	--

Sources: Federation of Tax Administrators; "State Tax Guide," Commerce Clearing House, Inc.; Energy Information Administration

[1] The brackets indicated apply to single taxpayers, but most states allow or require joint return filers to split their income.

[2] Local units of government may impose additional taxes.

**Table 3****STATE APPORTIONMENT OF CORPORATE INCOME  
(Formulas for tax year 2002 -- as of January 1, 2002)**

ALABAMA *	3 Factor	MONTANA *	3 Factor
ALASKA *	3 Factor	NEBRASKA	Sales
ARIZONA *	Double wtd. sales	NEVADA	No State Income Tax
ARKANSAS *	Double wtd. sales	NEW HAMPSHIRE	Double wtd. Sales
CALIFORNIA *	Double wtd. sales	NEW JERSEY (1)	Double wtd. Sales
COLORADO *	3 Factor/Sales & Property	NEW MEXICO *	Double wtd. sales
CONNECTICUT	Double wtd. sales/Sales	NEW YORK	Double wtd sales
DELAWARE	3 Factor	NORTH CAROLINA	Double wtd. sales
FLORIDA *	Double wtd. sales	NORTH DAKOTA *	3 Factor
GEORGIA	Double wtd. sales	OHIO	60% Sales, 20% Property & Payroll
HAWAII *	3 Factor	OKLAHOMA	3 Factor
IDAHO *	Double wtd. sales	OREGON *	Double wtd. sales
ILLINOIS	Sales	PENNSYLVANIA *	Triple wtd. sales
INDIANA	Double wtd. sales	RHODE ISLAND	3 Factor
IOWA	Sales	SOUTH CAROLINA	Double wtd. sales/Sales
KANSAS *	3 Factor	SOUTH DAKOTA	No State Income Tax
KENTUCKY *	Double wtd. sales	TENNESSEE *	Double wtd. sales
LOUISIANA	Double wtd. sales	TEXAS	Sales
MAINE *	Double wtd. sales	UTAH +	3 Factor
MARYLAND	Double wtd. sales	VERMONT	3 Factor
MASSACHUSETTS*	Double wtd. sales/Sales	VIRGINIA	Double wtd. sales
MICHIGAN	90% Sales, 5% Property & Payroll	WASHINGTON	No State Income Tax
MINNESOTA	75% Sales, 12.5% Property, and 12.5% Payroll	WEST VIRGINIA	Double wtd. sales
MISSISSIPPI	Accounting/3 Factor	WISCONSIN *	Double wtd. sales
MISSOURI *	3 Factor/sales	WYOMING	No State Income Tax
		DIST. OF COLUMBIA	3 Factor

Source: Compiled by FTA from various sources.

Note: The formulas listed are for general manufacturing businesses. Some industries have special formula different than those reported.

\* State has adopted substantial portions of the UDITPA.

(1) A 3-factor formula is used for corporations not subject to the corporation business franchise tax.